

Generally, sales of "canned" computer software are taxable retail sales in Illinois. See 86 Ill. Adm. Code 130.1935. (This is a GIL).

July 6, 2001

Dear Xxxxx:

This letter is in response to your letter dated April 5, 2001. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found at <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

In your letter, you have stated and made inquiry as follows:

Along with AAA's application to register as a vendor in your state, we have enclosed a description of the products and services offered to customers of AAA. I would like to request that you review this information and provide a ruling as to whether these items should be subject to sales tax in your state.

As a majority of our customers are higher education institutions, I would also request that you provide guidance as to the requirements for customers and AAA in situations where customers qualify to be exempt from sales taxes in your state.

I appreciate your response in advance.
If you have any questions, please contact me.

The Retailers' Occupation Tax Act imposes a tax upon persons engaged in the business of selling at retail tangible personal property. 35 ILCS 120/2. The Use Tax Act imposes a tax upon the privilege of using this State tangible personal property purchased at retail from a retailer. 35 ILCS 105/3.

The following is a discussion regarding canned and custom computer software and software licenses. Generally, sales of "canned" computer software are taxable retail sales in Illinois. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See subsection (c) of the enclosed copy of 86 Ill. Adm. Code 130.1935. Sales of software are taxable regardless of the means of delivery. For instance, the transfer or sale of canned computer software downloaded electronically would be taxable.

Custom computer programs or software are prepared to the special order of the customer. The selection of pre-written or canned programs assembled by vendors into software packages does

not constitute custom software unless real and substantial changes are made to the programs or creation of program interfacing logic. See subsection (c)(3) of Section 130.1935.

If transactions for the licensing of computer software meet all of the criteria provided in subsection (a)(1) of Section 130.1935, neither the transfer of the software or the subsequent software updates will be subject to Retailers' Occupation Tax. A license of software is not a taxable retail sale if:

- A) It is evidenced by a written agreement signed by the licensor and the customer;
- B) It restricts the customer's duplication and use of the software;
- C) It prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party) without the permission and continued control of the licensor;
- D) The licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or permitting the licensee to make and keep an archival copy, and such policy is either stated in the license agreement, supported by the licensor's books and records, or supported by a notarized statement made under penalties of perjury by the licensor; and
- E) The customer must destroy or return all copies of the software to the licensor at the end of the license period. This provision is deemed to be met, in the case of a perpetual license, without being set forth in the license agreement.

Charges for updates of canned software are fully taxable pursuant to Section 130.1935. If the updates qualify as custom software under subsection (c) of Section 130.1935, they may not be taxable. But, if maintenance agreements provide for updates of canned software, and the charges for those updates are not separately stated and taxed, then the whole agreement would be taxable as sales of canned software.

In general, maintenance agreements that cover computer software are treated the same as maintenance agreements for other types of tangible personal property. The taxability of maintenance agreements is dependent upon whether the charge for the agreement is included in the selling price of tangible personal property. If the charge for a maintenance agreement is included in the selling price of tangible personal property, that charge is part of the gross receipts of the retail transaction and is subject to Retailers' Occupation Tax liability. No tax is incurred on the maintenance services or parts when the repair or servicing is completed.

If maintenance agreements are sold separately from tangible personal property, the sale of the agreement is not a taxable transaction. However, when maintenance services or parts are provided under the maintenance agreement, the company providing the maintenance or repair will be acting as a service provider under the Service Occupation Tax Act. The Service Occupation Tax Act provides that when a service provider enters into an agreement to provide maintenance services for a particular piece of equipment for a stated period of time at a predetermined fee, the service provider incurs Use Tax based upon its cost price of tangible personal property transferred to the customer incident to the completion of the maintenance service. See 86 Ill. Adm. Code 140.301(b)(3), enclosed.

If repairs are made which are not covered by or are outside of the terms and conditions of a maintenance agreement, repairmen making such repairs would generally be considered servicemen and the transfer of tangible personal property incident to the sale of service would be governed by the Service Occupation Tax Act.

Assuming that the services provided, such as installation, phone support, training, and seminars, do not require the transfer of tangible personal property to the recipients of those services, charges for such services are exempt if they are separately stated from the selling price of canned software. See Section 130.1935(b). If computer software training or other support services are provided in conjunction with a sale of custom computer software or a license of computer software, the charges for that training are not subject to tax. If, however, tangible personal property were transferred incident to a sale of service, the taxation of the travel, installation, phone support and training expenses would depend upon which method the serviceman chose as a basis for paying Service Occupation Tax.

Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred incident to sales of service. For your general information we are enclosing a copy of 86 Ill. Adm. Code 140.101 regarding sales of service and Service Occupation Tax. The purchase of tangible personal property that is transferred to service customers may result in either Service Occupation Tax liability or Use Tax liability for the serviceman, depending upon which tax base the serviceman chose to calculate his liability. Servicemen may calculate their tax base in one of four ways: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on cost price if they are registered de minimis servicemen; or, (4) Use Tax on cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Web page creation and design would be considered provision of a service. Retailers' Occupation Tax and use Tax do not apply to receipts from sales of personal services. As stated above, under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred incident to sales of service. If tangible personal property is not transferred when providing a service, then no tax liability is incurred.

The Telecommunications Excise Tax Act, 35 ILCS 630/1 et seq., imposes a tax upon the act or privilege of originating or receiving intrastate and interstate telecommunications by persons in this State, based upon the amount of gross charges. See the Department's regulation regarding the meaning of "gross charges" at 86 Ill. Adm. Code 495.100, copy enclosed.

Generally, persons who charge subscribers for access to a specific Internet web site and who do not, as part of that service, charge for the line or other transmission charges that are used to obtain access to the Internet or that specific Internet web site are not considered to be telecommunications retailers from these activities. See 86 Ill. Adm. Code 495.100. However, if charges are made for transmission, the access charges need to be disaggregated from the transmission charges in the retailer's books and records. The retailer should then remit Telecommunications Excise Tax based upon the gross charges for the telecommunications he sells. If the access charges are not disaggregated from the telecommunications charges, Telecommunications Excise Tax is incurred on the entire amount.

Organizations that apply to the Department of Revenue and are determined to be exclusively religious, educational, charitable, or a government body receive an exemption identification number ("E" number). See the enclosed copy of 86 Ill. Adm. Code 130.2007. This number evidences that the Department recognizes the organization as exempt from incurring Use Tax when purchasing tangible

personal property in furtherance of its organizational purposes. If an organization does not have an E number, then its purchases are subject to tax. Organizations that are recognized as non-profit under Internal Revenue Code Section 501(c)(3), are not necessarily exempt organizations under Illinois law. Such organizations must obtain an Illinois E number to qualify. Please be aware that only sales to organizations holding the E numbers are exempt, not sales to individual members of the organization.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Martha P. Mote
Associate Counsel

MPM:msk
Enc.